Industry Canada Industrie Canada

Q1 2008 VENTURE CAPITAL MONITOR

Canadian high growth innovative small and medium-sized enterprises (SMEs) that commercialize research depend to a large extent on the venture capital (VC) industry for funding. Therefore, a strong VC industry is important for the growth of this segment of SMEs. The goal of this series is to provide current information about the VC industry in Canada. To this end, the series will track trends in investment activity, report on topical VC-related research and look at key technology clusters where VC investment is taking place.

INTRODUCTION

This issue discusses Canada's venture capital (VC) activity during Q1 2008. It includes an article that highlights some government, and government agency, VC investments announced during the quarter and provides an update on federal Budget 2007 announcements related to venture capital. An article on Edmonton describes the city's technology clusters, some supporting organizations, and a unique partnership between the University of Alberta technology transfer office and the Edmonton Economic Development Corporation that helps launch promising technology companies.

VC ACTIVITY OVERVIEW

Investment and fundraising

Significant decline in VC investment and fundraising

Venture capital investment in Canada totalled $323M (129 deals) in Q1 2008, down 47 percent from $610M (136 deals) in Q1 2007 (Table 1). This represented the lowest quarterly investment level in over two years and was largely influenced by decreased foreign investment in large deals. The significant contribution to total VC investment in 2007 from a small number of very large deals resulted in highly volatile quarterly VC levels.

Venture capital fundraising reached $334M in Q1 2008, slightly less than the $338M recorded in Q4 2007 and down 28 percent from $467M in Q1 2007.

Table 1
VC investment and fundraising, Q1 2007 and Q1 2008

	Q1 2007	Q1 2008	% Change
	($ millions)		
Investment	610	323	-47
Fundraising	467	334	-28

Source: Thomson Financial Canada 2008.

Deal size

Drop in large deals decreased average deal size

The average deal size in Q1 2008 was $2.5M, representing a significant drop from recent quarters. By comparison, the average deal size was $4.1M in Q4 2007 and $4.6M in Q1 2007 ($3.6M if the extremely large Geosign deal is excluded). A factor contributing to this decrease is that investors, foreign investors in particular, invested much less in large deals compared with previous quarters in both absolute and proportional terms (Figure 1). This drove down the average deal size inasmuch as the 129 deals in Q1 2008 are within the range seen in recent quarters.

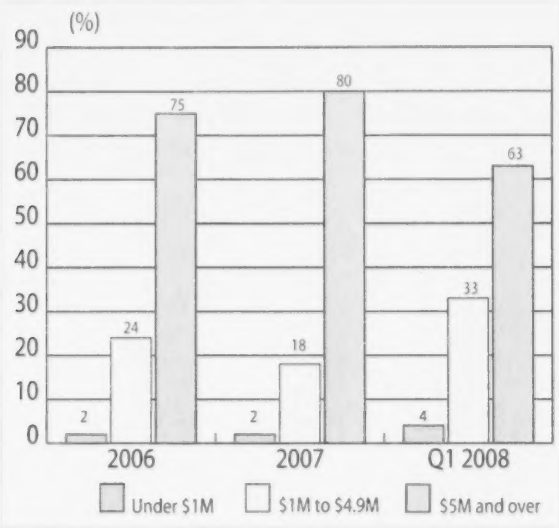
Stage of development

Drop in late-stage investments

The share of late-stage investments dropped, with 58 percent of VC investment placed in later stage Canadian companies in Q1 2008 (Figure 2). This is lower than in the whole of 2007, but equivalent to the 57 percent share held by late-stage

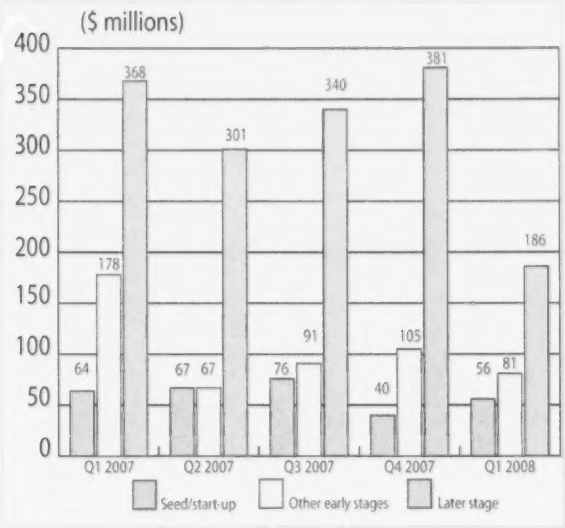
Canada

Figure 1
VC investment by deal size



Source: Thomson Financial Canada 2008.

Figure 2
VC investment by stage of development



Source: Thomson Financial Canada 2008.

investments in the whole of 2006. The overall drop in VC investments reported above mostly impacted funding for later stage companies. Although late-stage investments dropped significantly in Q1 2008, falling 49 percent from Q1 2007, investment in seed and start-up stages dropped only 13 percent.

The drop in late-stage investments was influenced by foreign investment trends. In 2007, foreign investors drove the increase in late-stage investments. With the large drop in foreign investment levels in Q1 2008, late-stage investments also declined.

Type of investor

Investment by foreign and retail funds declines

There was a decrease in the amount invested by both foreign and domestic funds (Table 2). The most notable decline, however, was registered by foreign sources, which invested only $76M (18 deals) in Q1 2008, down from $303M (14 deals) in Q1 2007 and representing only 23 percent of Canadian venture capital, lower than in recent quarters.

Labour sponsored venture capital corporation (LSVCC) and retail investments also declined significantly, totalling $57M (80 deals) in Q1 2008, down 50 percent from $113M (59 deals) in Q1 2007. The decline was most pronounced in Quebec, where retail investment in Q1 2008 dropped 70 percent from the same period last year.

Investment by private independent funds reached $82M (51 deals) in Q1 2008. This represents a drop from $97M (also 51 deals) in Q1 2007, but is within the range of quarterly investment levels observed in recent years.

Table 2
Distribution of VC investment by type of investor, Q1 2007 and Q1 2008

	Q1 2007	Q1 2008	% Change
	($ millions)		
LSVCC/retail funds	113.1	57.2	-49.4
Private independent funds	96.9	82.0	-15.4
Foreign funds	303.1	75.6	-75.1

Source: Thomson Financial Canada 2008.

Fundraising

Decline in fundraising continues

Venture capital fundraising in Canada reached $334M in Q1 2008, down 28 percent from Q1 2007 (Table 3). This overall decrease is due to a drop in fundraising by LSVCC/retail funds, but is partially offset by an increase in fundraising by private independent funds.

Table 3
Distribution of VC fundraising by type of investor, Q1 2007 and Q1 2008

	Q1 2007	Q1 2008	% Change
	($ millions)		
LSVCC/retail funds	396	164	-59
Private independent funds	70	170	143
Total	467	334	-28

Source: Thomson Financial Canada 2008.

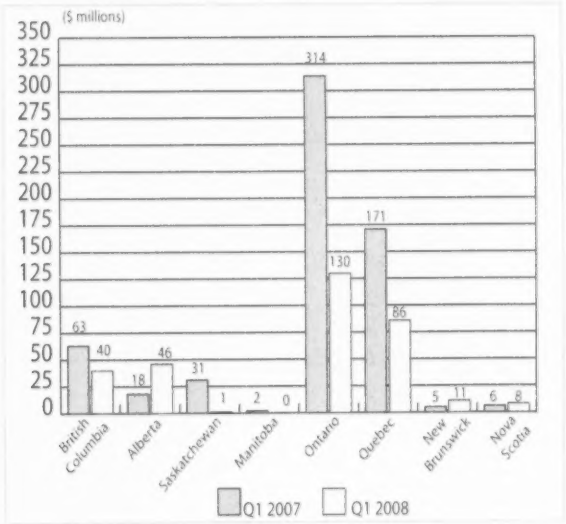
Regional distribution

Investment decreased in Ontario, Quebec and British Columbia, increased in the rest of Canada

Venture capital investment dropped significantly in Ontario and Quebec (Figure 3, Table 4). Venture capital investment in Ontario totalled $130M (42 deals) in Q1 2008, down from $221M (48 deals) in Q4 2007 and from $314M (50 deals) in Q1 2007. This drop is linked to significant declines in late-stage funding and foreign investment, insofar as a slight majority of Canada's late-stage funding and foreign investment in 2007 was placed in Ontario. Venture capital investment in Quebec reached $86M (41 deals) in Q1 2008, down from $196M (56 deals) in Q4 2007 and from $171M (55 deals) in Q1 2007.

The share of VC investment held by the three most populous provinces — Ontario, Quebec and British Columbia — dropped to 79 percent in Q1 2008, much lower than the average of 93 percent over 2007 and 2006. This occurred because investment in these three provinces in Q1 2008 was lower than in any quarter in 2007 and because investment in Alberta, New Brunswick and Nova Scotia was higher than in any quarter in 2007.

Figure 3
Regional distribution of VC investment in Canada, Q1 2007 and Q1 2008



Source: Thomson Financial Canada 2008.

Table 4
Number of companies receiving VC by province, Q1 2007 and Q1 2008

	Q1 2007	Q1 2008	% Change
British Columbia	13	15	15
Alberta	5	15	200
Saskatchewan	2	2	0
Manitoba	5	1	-80
Ontario	47	41	-13
Quebec	54	41	-24
New Brunswick	2	6	200
Nova Scotia	3	7	133

Source: Thomson Financial Canada 2008.

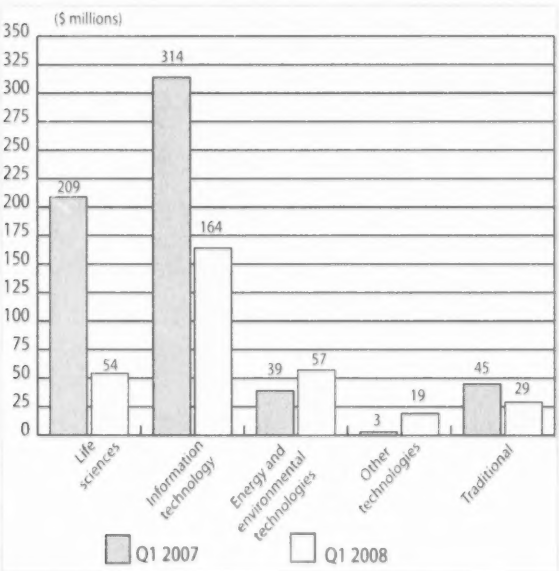
Industry sector distribution

Growth in energy and environmental technologies investment, decline in other sectors

Investment in the information technology (IT) and life sciences sectors declined significantly in Q1 2008 compared with Q1 2007 (Figure 4) because there were three very large deals in those sectors in Q1 2007 and no such large deals were reported in Q1 2008.

Investment in energy and environmental technologies totalled $57M (10 deals) in Q1 2008, up from $39M (12 deals) in Q1 2007, but lower than the $112M (14 deals) invested in Q4 2007.

Figure 4
VC investment by industry sector, Q1 2007 and Q1 2008



Source: Thomson Financial Canada 2008.

GOVERNMENT ACTIVITIES

In Q1 2008, the Business Development Bank of Canada (BDC) committed $34.4M in venture capital, in addition to $137.2M committed by co-investors, to 30 companies (Table 5).

Table 5
BDC deals in Q1 2008

	BDC ($)	Co-investors ($)	Total ($)
Seed	2 200 001	1 750 001	3 950 002
Start-up	13 530 224	49 519 776	63 050 000
Other early stages	6 662 029	41 874 504	48 536 533
Later stage	12 060 625	44 099 127	56 159 752
Total	34 452 878	137 243 408	171 696 286

Source: Business Development Bank of Canada 2008.

In Budget 2008, the Government of Canada proposed to set aside $75M for the BDC to support the creation of a new privately run venture capital fund.

Budget 2008 also proposes changes to enhance the cross-border investment environment by streamlining cross-border tax-withholding and tax-return-filing rules. These changes should simplify some requirements related to Section 116 of the *Income Tax Act*.

Avrio Ventures, a VC fund formed in 2006 with a $50M investment from Farm Credit Canada, announced in May 2008 that it raised capital from Export Development Canada and the Business Development Bank of Canada, bringing total capital commitments to the fund up to $75M.

The Government of Alberta, in its 2008 budget, announced a $100M investment to establish the Alberta Enterprise Corporation to provide early-stage venture capital to innovative companies.

In April 2008, the Government of British Columbia announced that it has launched the $90M BC Renaissance Capital Fund and secured six top-tier venture capital fund managers to help attract market expertise and venture capital investment to British Columbia. The fund managers are ARCH Venture Partners, VantagePoint Venture Partners, Kearny Venture Partners, Walden Venture Capital, Ventures West and Celtic House Venture Partners.

Update on VC-related announcements in federal Budget 2007

As reported in the Q1 2007 issue of the *Venture Capital Monitor*, the federal government made two announcements related to venture capital in Budget 2007:

The budget exempted shares of Canadian companies listed on "recognized" stock exchanges from being subject to the "Section 116" requirements described above. This came into effect when the *Budget Implementation Act* was granted royal assent in December 2007.

The budget announced that agreement in principle had been reached between Canada and the United States on updates to the tax treaty between the two countries. This included extending treaty benefits to limited liability companies, a structure used by many VC investors in the U.S. This measure will come into effect once the agreement is ratified in the U.S. and the two countries formally exchange ratification documents.

EDMONTON'S APPROACH TO BUSINESS INCUBATION AND TECHNOLOGY COMMERCIALIZATION

Alberta is well known for its oil and gas industries, but its provincial and municipal governments are actively promoting a more diversified economy — the commercialization of technology and more venture capital activity. For example, Edmonton is home to a number of technology-based industry clusters, including biomedicine and biotechnology, network services, software development, microelectronics, microsystems and nanotechnology, and advanced manufacturing. More than 2000 of Edmonton's firms are in information and communications technology clusters and another 225 firms operate in life sciences clusters.[1]

The city's technology clusters are complemented by many state-of-the-art research facilities. For instance, the University of Alberta, located in Edmonton, ranked among Canada's top five research universities in 2006 based on research intensity.[2] Currently, there are 73 active University of Alberta spinoff companies that employ over 1100 people.[3] Other leading research organizations in the region include TRLabs[4] for information and communications technology development, the Alberta Research Council and the National Institute for Nanotechnology.[5]

Edmonton also benefits from organizations that promote the development of technology companies and entrepreneurs. The ForeFront[6] program of the Alberta Heritage Foundation for Medical Research (AHFMR) provides mentoring, training and up to $685 000 in funding to promote the commercialization of medical technologies. In addition to the AHFMR, support for innovative companies is provided by the technology incubator TEC Edmonton. The result of a progressive partnership between the City of Edmonton and the University of Alberta, TEC Edmonton is designed to stimulate new company formation, the commercialization of research and investment activity.

[1] Edmonton Economic Development Corporation. http://www.edmonton.com/eedc

[2] Top 50 Research Universities List. (2007). RE$EARCH Infosource. http://www.researchinfosource.com/top50.shtml

[3] University of Alberta Facts. (2007). University of Alberta. http://www.ualberta.ca

[4] TRLabs. http://www.trlabs.ca

[5] Alberta Research Council. http://www.arc.ab.ca

[6] ForeFront. http://www.ahfmr.ab.ca/forefront

TEC Edmonton

TEC Edmonton was created in 2004 as a partnership between the University of Alberta and the Edmonton Economic Development Corporation (EEDC), a not-for-profit company, owned by the City of Edmonton, responsible for regional economic development. TEC Edmonton is an amalgamation of university and EEDC programs that provide the following services:

- The Alberta Deal Generator program connects entrepreneurs seeking financing with formal and informal investment.
- VenturePrize — a $200 000 business plan competition for new technology entrepreneurs — provides candidates with support and mentoring from experienced entrepreneurs and financing professionals.
- The technology transfer office and university spinoff programs support researchers who launch new businesses by providing advice on a range of topics.
- The business incubator program provides new technology entrepreneurs with business planning suggestions, product development assistance and market research.
- The TEC Source program, launched in September 2007, assembles a network of dedicated professional volunteers that provide expert business development advice to qualified start-up companies.

Linking the technology transfer office with the business incubator program and funding programs creates an integrated approach that alleviates many of the challenges that new technology entrepreneurs face, and promotes the commercialization of research and technology entrepreneurship.

NOTES

This publication is part of a series prepared by the Small Business Policy Branch. The branch analyses the financial marketplace and how trends in this market impact small businesses' access to financing. Current research is focused on high-growth firms, the aspects of both Canada's VC and general business environment that affect the success of these firms, and the key players in the risk-capital market (for example, VC firms and angels).

The Small Business Policy Branch is also responsible for the Small and Medium-Sized Enterprise Financing Data Initiative (SME FDI). The SME FDI is a comprehensive data-collection program on SME financing in Canada. In partnership with Statistics Canada and Finance Canada, Industry Canada reports on the supply of and demand for financing by small and medium-sized businesses. Further information and statistical findings and reports are available at www.sme-fdi.gc.ca.

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